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September 19, 1983

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF INTERIOR
THE SECRETARY OF COMMERCE
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION
ASSISTANT TO THE PRESIDENT FOR CABINET AFFAIRS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
DIRECTOR, FEDERAL EMERGENCY MANAGEMENT AGENCY

Subject: IG-IEP Study of Government Barter Policy

The IG-IEP has been tasked with examining the policy issues surrounding proposals for increased use of official barter arrangements (chiefly to help restructure the national defense stockpile and reduce CCC inventories) and to develop a decision memorandum for consideration by the SIG-IEP. A Treasury-prepared discussion paper on this issue is attached.

Assistant Secretary Leland will arrange a meeting to discuss this issue in the near future.

David E. Pickford
Executive Secretary

Attachment

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U.S. Government Barter Policy

I. Issue

The USG plays a substantial role in international commodities trade for its own account. Its trading involves, primarily, sales of CCC-owned agricultural commodities and both sales and acquisitions of materials for the National Defense Stockpile. In the current international trading environment, various kinds of barter and countertrade techniques have become increasingly popular, and pressures have mounted -- from both inside and outside the Government -- to employ barter in one form or another in the Administration's own official trading activities. A few ad hoc barter transactions have already been arranged; they have highlighted (1) policy conflicts that can arise as different USG programs are affected, and (2) the lack of a basic and comprehensive USG policy position on barter transactions. The IG-IEP has been asked to consider the issues and develop a decision memorandum for the SIG-IEP (see Tab A).

II. Essential Factors

A. Scope of the IG-IEP Review

The Trade Policy Committee directed an interagency staff group to examine the full range of "countertrade" issues, including barter, and to recommend policy options as appropriate. A TPSC paper, "Countertrade and Barter", ~~has~~ been approved ~~and~~ transmitted to the interested agencies by the TPRG (TPSC Document 83-93). In its recommendations the only reference to official barter arrangements was that the U.S. Government exercise caution in the use of its barter authority, limiting it to situations where it can offer advantages over conventional market operations. The U.S. Government also would be directed to undertake initiatives in several international fora and in bilateral discussions to discourage or circumscribe countertrade.

This recommendation, which is consistent with earlier language agreed to by the SIG-IEP, provides overall policy guidance. Because of the number of barter proposals made recently, however, the SIG-IEP should consider the content of additional operational guidelines. Consequently, this paper will focus only on the Government's policy of when and how it should use barter. The broader issue of policy on countertrade will remain in the TPC framework.

B. Sources of initiatives and pressures for more USG barter transactions

Impetus towards barter arises from several sources within the Administration, Congress, other governments, and private traders, specifically:

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- -- The Stockpiling Act of 1979 directed the President to use barter when it is in the best interest of the United States;
- -- In May 1981 the President directed that restructuring of the strategic stockpile get underway;
- -- USDA was instructed by the President in 1982 to examine barter opportunities as means of using the large quantities of CCC stocks to help acquire materials for the stockpile;
- -- There are several initiatives on the Hill to legislate that stockpile barter be undertaken on a continuing basis (see Tab B for legislation and scheduled hearings);
- -- The Senate Republican Policy Committee has circulated a paper which favors more aggressive barter of CCC commodities and strategic materials as a tool to promote foreign trade;
- -- There have been proposals urging that the Administration barter nonfat dry milk in CCC stocks for Mexican fluorspar;
- -- In 1982 the President agreed to several barter deals with Jamaica;
- -- Some other nations which export industrial commodities -- for example, Zaire, Kenya, Indonesia, and Mexico -- have approached agencies indicating a willingness to barter.

C. Sources of policy conflict

Actual and potential barter transactions cut across or otherwise cause an impact upon programs, policy objectives, or existing policies in several areas. These multiple impacts often reveal policy conflicts that either require some policy objectives to be subordinated to others or put the USG in a position of looking the other way when a transaction undertaken for some overriding reason causes a strong policy position in another area to be compromised. Among the issues in this regard are (1) Consistency with existing legislation, including trade law; (2) consistency with U.S. international obligations; (3) basic U.S. trade and commercial policy; (4) political factors; (5) consistency with stockpile goals and priorities; (6) consistency with USDA policies and objectives; and (7) broader economic issues such as the international debt problems facing many LDCs.

Existing law

Stockpile law. The Strategic and Critical Materials Stock Piling Act (50 U.S.C.; 98 et. seq.) is specific about the purposes of the stockpile. In discussing the contents, disposals and acquisitions of the stockpile, and how the President shall make these determinations, the Act says, in relevant part:

> The purpose of the stockpile is to serve the interest of national defense only and is not to be used for economic or budgetary purposes. [SEC. 3(b)(1)]
>
> The President shall encourage the use of barter... when acquisition or disposal by barter is authorized by law and is practical and in the best interest of the United States. [SEC. 6(c)(1)]
>
> Materials in the stockpile, the disposition of which is authorized by law, shall be available for transfer at fair market value as payment for... acquisition of materials... [SEC. 6(c)(2)]

One legal interpretation of the fair market value stipulation (6(c)(2)) in the Stock Piling Act has concluded that it is Congress' intent in this section governing barter to ensure that the stockpile is used for purposes of national defense only and to discourage its use for other purposes.

To the extent that a particular barter transaction benefits the foreign exchange reserves or balance of payments situation of a foreign country and the effective price charged that country for the commodity delivered to it out of the strategic stockpile is less than fair market value, this may constitute an economic use of the stockpile for the primary benefit of another government. While the transaction may be in the best interest of the United States since it permits the strategic stockpile to acquire a needed material, the same benefit might accrue to the United States if the same transaction could have been made at fair market value. If a subsidy element is a necessary part of the transaction, it may violate legislative constraints on stockpile disposals. (See Tab C for background on stockpile management and organization).

CCC law. The Department of Agriculture (USDA) through its Commodity Credit Corporation (CCC) has legislative authority to barter surplus commodities from CCC stocks, as well as from the National Defense Strategic Stockpile, for other materials which are needed in the Strategic Stockpile. The barter authority for CCC is generally considered to be a tool for disposing of surplus agricultural inventories while GSA's authority is a tool for managing the changing composition of the Strategic Stockpiles. The CCC acquired barter authority in 1949, while GSA has been using barter since the early 1950's.

The U.S. Barter Program, as operated under Public Law 480 (P.L.-480) from 1954 to 1962, was primarily used to exchange CCC-owned agricultural commodities for strategic materials. Starting in 1963, P.L.-480 barters for strategic materials were curtailed and the U.S. Barter Program was used primarily to procure foreign-produced supplies and services used in construction projects for the Department of Defense and in projects of the Agency for International Development under the authority of the CCC Charter Act. The Barter Program was suspended in 1973 when CCC stocks were largely depleted and the supply of private stocks no longer justified the need for a barter program. A second kind of legislative authority, written into the Foreign Assistance Act of 1974, gives the President power to barter foreign assistance and services for strategic materials. No President has used this power.

International trade considerations

Domestic Trade Laws. Strategic materials purchased for the national stockpile, if acquired at dumped or subsidized prices, could be liable for antidumping or countervailing duties. However, depending upon the share of imports represented by the barter transaction, the degree of subsidization/dumping of imports may be *de minimis* and would not precipitate a complaint.

The fact that the Government is the importer in this case makes no difference under U.S. laws. However, U.S. Government agencies can request Customs to waive duties on the import of goods they purchase. Such a waiver could include waiving any assessed countervailing or dumping duties.

GATT Subsidies Code. Under the GATT subsidies code, the U.S. is obligated not to subsidize agricultural exports in a manner that takes more than an equitable share of world markets or results in material price undercutting. The barter of CCC commodities would likely entail government subsidies to permit the sale below acquisition prices. Other governments could be expected to complain if the barter involved a substantial quantity of CCC commodities which would increase the U.S. share of the world market for that commodity as compared to a recent representative period (usually three years).

U.S. Commercial policy

Distortion of Commercial Markets. Past experience with CCC barter programs revealed the difficulty of assuring that barter exports do not displace normal commercial sales. The frequent price discounts involved in barter also encouraged price-cutting by other exporting countries, resulting in market disruptions.

Economic Efficiency. The barter of CCC stocks for strategic materials may be beneficial in budget terms if it is the most efficient way of obtaining priority materials which we would otherwise be purchasing anyway, if the carrying costs of the CCC stocks exceed the storage costs for the acquired strategic materials, and if the Government is bound to take a loss on the CCC stocks in any event (i.e., the cost of acquisition cannot be recaptured and the value of the stocks is likely to decline over time).

Barter generally tends to be less efficient than purchases on the open market for cash, entailing some "loss" on either the import or the export side (through implicit export subsidies or higher cost of the acquired good). Determining the efficiency of the transaction normally would include looking at:

-- the cost of acquisition of the ~~CCC~~ commodity and/or its current market value relative to its sale price (the first comparison will provide the amount of government subsidy or "loss" on the export from the time of acquisition, while the second involves a net asset adjustment);

-- the purchase price of the strategic material relative to world market prices or the least cost supplier;

-- the carrying costs of both commodities;

-- the priority of the purchase;

-- the feasibility of correcting the market distortion that may have caused the accumulation of government-owned stocks (e.g., high support prices).

Political considerations

The Government's consideration of barter proposals usually must take into account three sets of political interests: (1) the farm community's interest in surplus disposal, (2) the

U.S. mining industry's interest in having first right of supplying materials to the stockpile, and (3) the interest of developing countries in obtaining U.S. surplus food for their raw materials without using up scarce foreign exchange.

The farm community has often been the leader in efforts to use barter. Although the ultimate objective is surplus disposal, proposals are usually framed as a package deal whereby surpluses are being exchanged for needed raw materials with the U.S. Government gaining a double benefit. When CCC runs out of surplus commodities or GSA needs no more raw materials, barter proposals disappear.

The U.S. mining industry has been less vocal on barter, but nevertheless is vigilant that acquisition of foreign source materials does not displace potential domestic sales. In many cases the U.S. is wholly dependent, or nearly so, on foreign supplies, so no conflict with domestic miners occurs. But if a proposal were made to barter CCC commodities for copper, then the U.S. copper industry would be heard from -- early and loudly.

Foreign political interests can cover a wide range -- from a simple good-will gesture of providing surplus food for token raw materials to a major effort to relieve a food import shortage caused by lack of hard currency due to weak international markets for the country's industrial commodities.

USDA and GSA policies

Conflicts between USDA and GSA can arise because USDA objectives focus on surplus disposal or market promotion while GSA objectives focus on acquiring materials for the stockpile according to an established priority list. Since the customers for USDA's excess commodities rarely mesh exactly with sources of strategic materials on GSA's highest priority list, GSA is often asked to accept lower priority materials in order to close a deal. This can have a double impact on the stockpile restructuring process when, as is usual, USDA insists on a cash payment (transfer) from the Stockpile Transaction Fund to compensate it for the barter "sale" of surplus farm products. GSA thus gives up cash earmarked for high-priority stockpile acquisitions.

Broader issues

The Government often has to address broader implications of decisions on whether to undertake a particular barter arrangement. For example the enormous CCC inventories of dairy products are costing several hundred million dollars a year in storage and interest costs and the possibility of recovering those costs through future sales is small. Thus, a barter arrangement could result in the GSA acquiring inventories of strategic materials at little or no cost to the Government; in fact there might be a net saving in storage costs. CCC will, however, have to recover the value of its inventory loss through appropriation -- either through a restoration by Congress of borrowing authority or by reimbursement from GSA's stockpile transaction fund. These short term cost savings, however, may promote delay in reforming the highly costly dairy support program, thus leading to even larger outlays over the long term.

There also is the question of whether a particular barter program may significantly aid a country's efforts in coping with its debt problems. If so, then an arrangement to bridge a difficult period may help prevent a disruption of financial markets at very little cost to the U.S. Government.

A further danger of undertaking many barter arrangements for strategic stockpiles is that extensive GSA reimbursement commitments may reduce its future flexibility in its restructuring of the stockpiles.

Finally, there is the danger that several Government-to-Government barter deals will strengthen the tendency for foreign countries to require barter or countertrade deals, thereby frustrating the overall policy goal of discouraging countries from requiring such arrangements which ~~we~~ believe detract from the efficiency of the international trading system.

III. Policy Options

In deciding on the appropriate Administration stance with respect to barter, the SIG-IEP may want to consider the following four options:

A. Oppose all barter deals.

B. Maintain the present *ad hoc* procedure of deciding each proposal on the basis of benefits to the U.S., justifying an exception to a general policy of opposition.

C. Support or introduce legislation that clarifies when barter is to be used and provides for any additional authority which is necessary.

D. Adopt a set of guidelines developed by the IG-IEP, specifically:

1. All barter proposals are to be examined by the IG-IEP and implemented only after approved.

2. The initiating agency in preparing the proposal must address the following questions:

   a. Does it undermine adjustment programs imposed by the IMF?

   b. Do the exported U.S. commodities replace cash sales by the U.S. or competitors and do the imports add to overall trade for the strategic material?

   c. Does it adversely affect the U.S. balance of payments?

   d. Does it conflict with U.S. trade law and policy and our adherence to international obligations?

   e. Does it conflict with strategic stockpile or CCC statutes, or with budget policy?

   f. Does it subvert the annual materials plan for stockpile disposals and acquisitions?

   g. Does it meet our international political objectives?

3. If the IG-IEP cannot agree on disposition of the proposal, it will be referred to the SIC.

Discussion

Blanket opposition to barter (option 1) would be most consistent with the U.S. free market philosophy and the commitment to a trading system less encumbered by inflexible bilateral arrangements. Such a policy also would simplify the operational and budgetary considerations in managing the CCC and strategic stockpile programs. Further, it removes the temptation to use barter as a disposal mechanism for CCC surpluses. On the other hand, strict opposition to barter proposals may be an excessively rigid policy which could prevent the Government from engaging in such arrangements when they are clearly beneficial to the U.S. on economic or political grounds. In addition, such inflexibility could be taken by the farm community, Congress, and interested developing countries as insensitiveness to the difficult problems facing various sectors and countries.

Continuing with the present ad hoc policy (option 2) is the easiest course but it would likely result in a hit or miss pattern of barter deals which would waste resources, contribute little to the U.S. policy objectives, cut down GSA management flexibility, undercut our overall countertrade policy, and ultimately lead to abuse. Some people would argue that there have been very few barter deals to date and that the few that will be proposed in the future can easily be handled on an ad hoc basis. It also is a logical approach to consideration of highly complex cases where guidelines can't adequately take into account all the conflicting economic, budgetary, trade policy, foreign policy, farm policy, and strategic stockpile aspects of each proposal. As a safeguard against abuse any highly controversial proposals could be referred to the SIG-IEP for approval.

The third option, to support or introduce legislation, would elicit a very positive response from Congress and could preempt undesirable bills now in the mill. The large number of bills that have been introduced and the paper by the Senate Republican Policy Committee attest to the widespread interest in this issue. In addition, some strong supporters of stockpile restructuring have been dismayed by the difficulty in appropriating funds for acquisitions. To them, a promising strategy is to negotiate some barter arrangements for strategic materials now when markets are weak and let CCC hold an IOU until GSA can muster the funds for reimbursement. The chief arguments against this option are: (1) that adequate authority already exists to barter either CCC commodities or GSA surpluses for materials to be included in the stockpile, and (2) new laws are likely to reduce the Administration's flexibility in managing all three programs -- farm, stockpile~~, and~~ barter progra~~ms~~.

The main advantage of option 4, adoption of guidelines, is that it gives the Administration the opportunity to announce a specific policy on an important subject, while reserving flexibility in implementing it. The proposed guidelines do not go significantly beyond sound procedures which should already be in force, but they would be explicit, so that all parties -- U.S. agencies, foreign trading partners, and interested U.S. groups -- will understand the general criteria for viable barter proposals. It would be fully consistent with the TPSC recommendations in the countertrade paper. The main disadvantage of this option is that it raises the visibility of barter, and will likely encourage additional proposals which meet the criteria, making it more difficult to turn them down.

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